CHAPTER III

PUBLIC REVENUE - PRINCIPLES OF TAXATION

I. Revenue of the State.

II. Methods of Raising Revenue.

III. Purposes of Taxation.

IV. Definition of a Tax.

V. Canons of Taxation.

VI. Taxable Capacity of a Country.

-oOo-

CHAPTER III

PUBLIC REVENUE - PRINCIPLES OF TAXATION

I. The Revenue of the State:-

The ordinary revenue of the State may be divided into the earned revenue which arises in a manner similar to that of the private household, and that which is compulsorily obtained in the form of taxation. The earned revenue is that which is obtained from the direct use and operation of its natural resources, or when it engages in industry in a manner similar to private enterprise. Amongst these are included the revenues from the Post Office, State banks, and railways, and from the State ownership of land.

In speaking of earned revenue, we may distinguish between the income which is derived from the State ownership of land, and that obtained from public industries. Formerly, the most important part of the revenue of the State was derived from the royal domain. Indeed, the sovereign held his position in part, at least, by virtue of the fact that he had large estates of land which would yield him an income sufficient to meet the expenses of the Royal Household. As the various rulers squandered their landed possessions, revenue from this source declined in importance.

The declining importance of public revenue from the ownership of land has been counterbalanced in many States by an expansion of Government activity in the sphere of industry. The motives which induce the public authority to undertake industrial enterprises are not always connected with the raising of revenue. Thus, the Government may take over certain forms of economic activity which are necessary to the community, but which private enterprise is unwilling or unable to provide. On such grounds many Governments have been compelled to construct and operate railways. Again, the State may acquire and nationalize certain industries in order to prevent the members of the community from being exploited by private monopolists. In other cases certain services may be provided by the State, because it is thought that they can be provided more cheaply and efficiently by this means. Finally, and less frequently, an industry may be taken over and operated with a view to raising the maximum revenue. Thus the French tobacco monopoly has yielded large contributions to the French Treasury, either in the form of taxes or as monopoly profits. Frequently, of course, Government ventures into industry do not yield a surplus for the relief of taxation, but deficits are incurred which have to be made good by the taxpayer.

The unearned revenue of the State is composed of contributions which are imposed upon its subjects without any proportionate counter-service being rendered. Revenue of

this type may be derived from two main sources, namely, fees and taxation. A fee is a charge made for a special service rendered to the individual by some governmental agency. The amount of the fee is supposed to be based upon the cost of the service rendered, or at all events upon the special cost of maintaining the department which performs the work, although in practice many fees are arbitrarily adjusted without regard to the present cost of the service. Yet, though a fee is greater than the actual cost of the service, warrants, it may still be differentiated from a tax on the ground that a special benefit is being conferred, and that if a person is prepared to forgo the benefit, he need not pay the fee.

The revenue which is derived from taxation in the modern State transcends in importance that received from other sources. A tax has been defined by Bastable as "a compulsory contribution of the wealth of a person or body of persons for the service of the public powers". The great importance of the subject of taxation arises not only on account of the important share which it contributes to the income of the modern State, but also on account of the problems, theoretical and practical, to which it gives rise. The amount of taxation will be largely dependent upon the expenditure incurred by the Government in the performance of its legitimate functions. Having settled the absolute amount of taxation, the next question is the manner in which the taxes are to be levied. Finally, it will be necessary to form an estimate as to what

Revenue of the State

Earned Revenue

Public Domain

Public Industries — managed to raise revenue. Sometimes monopoly.

Gratuitous

Unearned Revenue

Compulsory

Taxes

Fees

Methods of raising Revenue.

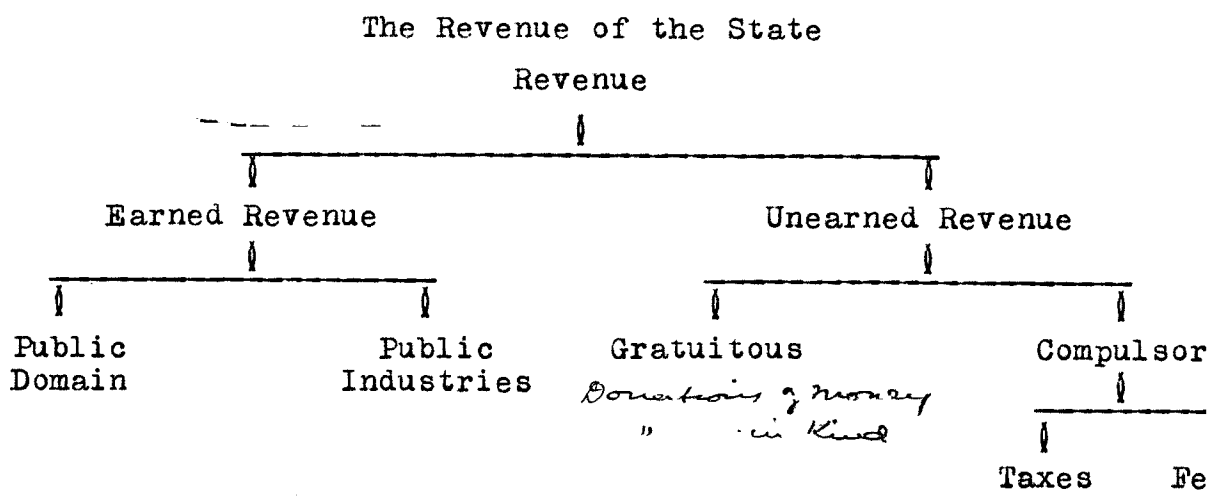
(1). State owned property may yield an income — what is there in State in Europe?

(2). Govt. carries on commercial undertakings, in profit — Post Office

(3). Govt may borrow money by issuing an interest

(4) - Taxation - most important

their ultimate economic effects are likely to be.



II. Methods of Raising Revenue:-

Revenue may be raised in several ways:

1) State-owned property may yield an income, e.g. the interest on shares held by the State in the Suez Canal, or in British Dyestuffs. Ltd., etc. At present this is an insignificant proportion of the total, but it need not necessarily be so in the future. If certain industries were nationalized the Government might decide to lease them to a private firm for a share in the profits obtained.

2) Governments may carry on commercial ventures for profit. The Post Office generally has a balance on the right side, although the motive of profit is not the dominant one. In most continental countries the manufacture of tobacco and matches is a State monopoly, run so as to yield a large revenu

3) The Government may borrow money. This, however, can only be a temporary expedient. Other ways of getting money must be found, not only finally to repay the principal, but annually to pay interest and administrative charges.

4) Taxation is by far the most important method.

III. Purposes of Taxation:-

A tax is a compulsory contribution from the inhabitants of a country to the State. Its main purpose is to obtain revenue for the business of government, but there may be other minor aims too.

(a) A tax may be imposed on goods coming from certain areas with the object of protecting native industry.

(b) If those in authority believe a certain commodity to be socially undesirable, and yet do not wish to prohibit it altogether, they may put a tax on it so as to discourage the purchase of it, e.g., a tax on drink.

(c) By carefully arranging the burden of taxation, attempts may be made to effect a redistribution of wealth. For example, free education, advantage of which will be taken mostly by the poor, may be paid for by taxes levied on the rich.

It is not easy to gauge to what extent these motives for taxation enter into practical policy. They play certainly

369

a very secondary part, except in the case of (a). The tax on drink, for example, is levied because it is in the highest degree remunerative, but at the same time we may congratulate ourselves on killing two birds with one stone; and the money is raised without impairing the health and efficiency of those who pay it. The same criticism applies to (c). Are these taxes imposed in order to bring about a redistribution, or because experience has shown them to be the best methods of raising revenue? The latter certainly; the redistribution they cause is an incidental effect, an added advantage perhaps, but not part of the prime motive.

IV. Definition of a Tax:-

A tax is a compulsory contribution, levied upon persons (natural or corporate) for the general purposes of Government.

The definition of a tax emphasises two elements:

(i) A tax is compulsory.

(ii) It is not a measured payment for benefits received by individual tax-payers. In other words, a tax-payer does not pay taxes in the modern state in proportion to the benefits which he receives from the state. Taxes are thus distinguished from prices - a price is a measured and proportionate payment.

Fees and special assessments are contributions made by persons to the government for special benefits received

Canons of Taxation ....

(1). Canon of Equality :- Subjects to contribute towards support of government in proportion to respective abilities; i.e. in proportion to revenue which they respectively enjoy under protection of state. In the observance or neglect of this maxim consists what is known as the equality or inequality of taxation.

(2). Canon of Certainty :- Tax each individual is bound to pay ought to be certain & not arbitrary. Time, manner, quantity of payment all ought to be clear & plain to contributor & to every other person. Where otherwise tax payer in power of tax gatherer who may either aggravate the offence of an obnoxious tax; or by bribes or presents of such aggravation may procure to himself exemption.

(3). Canon of Convenience :- Every tax to be levied at the time or in the manner, in which it is most likely to be convenient for the contributor to pay it.

(4). Canon of Economy :- Every tax is devised in such a manner as to keep as far as possible, most close to the pockets of the people as little as possible over & above what it brings into the public treasury of the state.

(1) Taking a wrong view of taxation from individual point of view.
(2) Standpoint of state.
(3) Gain is not kept as far as possible close to the pockets of the people.

(1). Bureaucracy to collect taxes.
(2) Obstruction in the way of people.
(3) Expenditure & penalties in people to evade the tax.

(4) Frequent vexatious calling of tax gatherers every subject than is necessary in order.

by them; taxes are levied to defray the expenses of the state for conferring common benefits upon the citizens of the state, and not special benefits to particular persons.

Taxation is by far the most important source of public revenues in all progressive modern states. India raises almost half of her public revenues from non-tax sources, such as railways, post-offices and irrigation; and this is because heavy taxation of the ordinary kind as practised in rich and progressive countries would be impracticable in such a poor country as India. In England, France, the United States and other wealthy and flourishing countries, taxation provides much the greater proportion of the public revenues.

V. Canons of Taxation:-

The four canons of taxation as enunciated by Adam Smith in the Wealth of Nations are -

(1) Canon of Equality:-

The subjects of every State ought to contribute towards the support of the Government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the State. The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate,

who are all obliged to contribute in proportion to their respective interests in the estate. In the observance or neglect of this maxim consists what is called the equality or inequality of taxation.

(2) Canon of Certainty:-

The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put, more or less, in the power of the tax-gatherer, who can either aggravate the tax upon any obnoxious contributor, or extort, by terror of such aggravation, some present or perquisite to himself.

(3) Canon of Convenience:-

Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it. A tax upon the rent of land of houses, payable at the same term at which such rents are usually paid, is levied at the time when it is most likely to be convenient for the contributor to pay; or when he is most likely to have wherewithal to pay. Taxes upon such consumable goods as are articles of luxury are all finally paid by the consumer, and generally in a manner that is very convenient for him. He pays them by little and little, as

he has occasion to buy the goods. As he is at liberty, too, either to buy, or not to buy, as he pleases, it must be his own fault if he ever suffers any considerable inconveniency from such taxes.

(4) Canon of Economy:-

Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the State. A tax may either take out or keep out of the pockets of the people a great deal more than it brings into the public treasury in the four following ways. First, the levying of it may require a great number of officers, whose salaries may eat up the greater part of the produce of the tax, and whose perquisites may impose another additional tax upon the people. Secondly, it may obstruct the industry of the people, and discourage them from applying to certain branches of business which might give maintenance and employment to great multitudes ..... Thirdly, by the forfeitures and other penalties which those unfortunate individuals incur who attempt unsuccessfully to evade the tax, it may frequently ruin them, and thereby put an end to the benefit which the community might have received from the employment of their capitals. Fourthly, by subjecting the people to the frequent visits and the odious examination of the tax-gatherers, it may expose them to much unnecessary trouble, vexation and oppression.

3,4

Sir Josiah Stamp suggests that taxation questions may be looked at from three different standpoints:

i) The standpoint of the individual taxpayer.

ii) The standpoint of the Government imposing the taxes.

iii) The standpoint of society as an economic organization producing, exchanging and consuming things.

Sir Josiah Stamp maintains that "most taxes in practice represent the best practical compromise between the three standpoints that can be arranged in the particular circumstances of the time".

From the standpoint of the individual taxpayer, his ability to pay is to be considered and also how ability is to be measured by income or expenditure or both and also how his income is to be calculated, what exemptions and concessions are to be granted and also the question of progressive versus proportional taxation.

From the standpoint of the state, the state as a tax-gatherer has to consider

(a) whether the tax is economical and the cost of collection is moderate;

(b) whether it is practicable and within the powers of the administration for assessment and collection;

(c) whether it is specially liable to fraud and evasion;

(d) whether the imposition of the tax tends to dry up the source of the tax;

(e) whether it raises political difficulties at home and provokes unrest;

(f) whether it raises international difficulties.

From the standpoint of the economic society we have to consider the economic effects of the tax on production, distribution, exchange and consumption of wealth, accumulation of capital etc. For example, progressive taxation is advocated among other reasons on the ground that it secures a better distribution of wealth within the community. Also we have to consider certain non-economic effects, e.g. the health of the community, the prevention of crime etc. in connection with the taxation of things like alcoholic liquors.

VI. Taxable Capacity of a Country:-

We have now to examine the question as to how much taxation a country can bear, that is, what is the taxable capacity of the nation? The concept of taxable capacity is obviously one of the greatest importance, since it informs us as to the maximum amount of wealth which the citizens of a country can contribute towards the expenses of the State without having to undergo an unbearable strain. We may

evaluate the taxable capacity as the difference between the national production and the minimum consumption of commodities and services required to maintain that volume of production, the standard of living remaining unaltered.

Now these matters do not readily lend themselves to precise measurement. The national income, which is the money value of the goods produced and the services performed in a community within a given space of time, cannot be measure with any high degree of accuracy on account of the duplication of items and the many services which cannot be valued. On the other hand, the minimum consumption necessary for efficiency presents further difficulties of ascertainment. But assuming that these difficulties could be cleared away, we have still to consider the psychological reaction of the taxpayer to the situation. We may determine the minimum amount of the national income which must be left to the producer in order to leave him in a position to maintain his former volume of production, but we have still to ask ourselves whether he will be willing to continue to put forth the same effort on such terms. As Sir Josiah Stamp says, "taxation is not merely a stationary or a static problem, the cutting up of an existing cake - it is a moving and a dynamic problem. We have to ask not only how little we can leave him with, but also, how much reduction will he stand before he slackens in work and abstinence. How long will he come up smiling to be taxed in this way?".

In the face of a diminution of income due to increased taxation, one person may work harder in order to maintain himself at the former level. In consequence, production may increase by roughly the amount of the tax. On the other hand, his reaction may be a feeling of discouragement - a disposition to give up the unequal struggle, so that business enterprise may be checked and the volume of production curtailed.

Sir Josiah Stamp enumerates the following factors on which taxable capacity of a nation depends:

1. It depends upon what the taxation is to be used for.

2. It depends upon the spirit and national psychology of the people taxed, which may be influenced by patriotism or sentiment.

3. It depends partly on the way the taxation is raised, both as to the methods adopted and the rate at which the increase is laid on.

4. It depends on the distribution of wealth.

5. Its rate of increase is greater than the rate of increase in wealth, and it shrinks more rapidly than the wealth diminishes.

Taking these factors in order, we may probably assign

the greatest importance to the first. If the proceeds of taxation are applied in the payment of internal debt interest, then the taxable capacity would be greater than if the money was applied in the service of foreign debt. In the payment of interest on an internal debt, the goods taken away from the taxpayers in their capacity as producers are returned to them in their capacity as receivers of interest. The mode of distribution may be different, but the national income will suffer, at most, only a small reduction. If, however, the proceeds are applied in the service of a foreign debt, then the sum paid away is a loss to the national income, and leaves the community poorer. Secondly, as we have already seen, the psychological attitude of the people to taxation will react on their productivity, and consequently on taxable capacity. This factor may be modified by appeals to sentiment and patriotism. Thirdly, the manner in which the taxation is imposed will have a considerable influence upon taxable capacity. Taxes which set in defiance the canons of taxation which we have enunciated above are likely to prove much more burdensome than taxes which are very much heavier, but which are fixed in accordance with those principles. Fourthly the distribution of the national income influences taxable capacity which will not be the same if incomes are more or less equal, as it would if they were graduated. Finally, taxable capacity shrinks more rapidly than national income falls, because there is a minimum which must be retained in

97/9
15

A07

the hands of the people for bare subsistence, and, as this point is approached, the yield of taxation falls quickly.

-oOo-